



OCTOBER 2020

Central Bank of Ireland Findings on the Adoption of the Fund Management Company Guidance

On 20 October 2020, the Central Bank of Ireland (the “**Central Bank**”) issued a [“Dear Chair” Letter](#) to industry outlining the findings of its review of the implementation by Irish fund management companies of the Central Bank’s framework for effective governance, management and organisation (the “**Letter**”).

While further clarity is going to be required from the Central Bank in a number of areas, it contains significant developments which will require prompt action.

The Letter follows a thematic review by the Central Bank of how Irish UCITS management companies, authorised Alternative Investment Fund Managers (AIFM), self-managed UCITS and internally managed Alternative Investment Funds (“**management companies**”) have implemented the Central Bank’s Fund Management Company Guidance which was issued in December 2016 (the “**Guidance**”)¹ and the related legislative requirements which underpin it². The Letter addresses many of the same topics as were raised in ESMA’s 18 August 2020 letter to the European Commission on its review of the Alternative Investment Fund Managers Directive (the “[ESMA Letter](#)”) in relation to substance and delegation of managerial functions³ and ESMA’s July 2017 *Opinion to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the European Union* (the “[ESMA Brexit Opinion](#)”).

¹ The Guidance introduced a framework for fund management companies to implement effective governance, management and oversight arrangements. The Guidance came into effect for new management companies from 1 July 2017 and for existing management companies on 1 July 2018. Section F of Part I of the Guidance, which deals with delegate oversight, applies to funds that are externally managed.

² In the case of UCITS management companies and self-managed UCITS, the European Communities (Undertakings for Transferable Securities) Regulations, 2011, as amended and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)(Undertakings for Collective Investment in Transferable Securities) Regulations 2019; in the case of AIFMs and internally managed AIFs, the European Union (Alternative Investment Fund Managers) Regulations, 2013, as amended.

³ Further information on the ESMA Letter is available from our [client briefing](#) on the topic.

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The Letter signals the Central Bank's intention to retain the Guidance as its principal governance framework for management companies going forward, though it indicates that the review and findings will inform its consideration of policy development and potential future enhancements to the existing regulatory framework in the future.

The Letter identifies that certain management companies have not yet fully implemented the current framework. As a result of these findings, some firms will shortly receive "risk mitigation programmes" ("RMPs") from the Central Bank. Any such RMP will identify specific actions which the management company is required to take. Whether or not a management company receives a RMP from the Central Bank, the Letter requires all management companies to critically assess their day to day operational, resourcing and governance arrangements against all relevant rules and guidance, taking into account the findings of the Central Bank's review. Each management company is required to implement a plan for making the necessary changes to ensure compliance and to have that plan approved by its Board by the end of the first quarter of 2021.

Substance and resourcing

Consistent with the approach taken in the ESMA Brexit Opinion⁴, the Letter sets out that the requirement for three full time employees (or equivalent) ("FTEs") is "*a minimum expectation and only relevant to the smallest and simplest of entities*" and notes that other firms "*will be expected to have a level and quality of resourcing determined by the nature, scale and complexity of its operations.*"⁵

Many smaller management companies, including a large number of self-managed and internally managed funds, have to date been permitted by the Central Bank to operate with significant (but not full-time) support from individuals carrying out designated managerial functions as opposed to having full-time staff. These individuals have tended to be seconded to the management company from the investment manager's or fund sponsor's group or from local consultancy firms. The location of these individuals has generally been split between Ireland and the location of the investment manager / fund sponsor in accordance with the Central Bank's so-called "Location Rule", described below. Generally those individuals would have accounted for fewer in aggregate than three FTEs.

Further clarity will be required from the Central Bank to establish how individual firms will calibrate their resourcing requirements and whether the FTE requirement can be met by increasing the time commitments of designated persons and to what extent the Central Bank will continue to permit designated persons to be located outside of Ireland.

Subject to any further guidance emanating from the Central Bank, management companies and self-managed and internally managed funds that are currently operating with fewer than three FTEs will now need to consider how they are going to address this requirement. Their options may include;

⁴ Paragraph 60 of the ESMA Brexit Opinion recommends that Member State regulators *should apply additional scrutiny* to situations where relocating entities, even those of smaller size employing simple investment strategies and having a limited range of business activities, do not dedicate at least 3 locally-based FTE (including time commitments at both Senior Management and staff level)

⁵ An FTE role assumes 220 working days per year.

- (i) increasing the time commitments of those designated persons performing managerial functions to equate to three FTEs;
- (ii) hiring full-time or part-time staff;
- (iii) in the case of self-managed funds, appointing an external management company (group or third party) to manage these funds;
- (iv) in the case of self-managed funds, establishing an Irish management company to appoint to manage these funds.

Performance of Managerial Functions

The Letter requires management companies to critically assess the time commitment, skills and expertise of its available resources, including its designated persons and, in particular, to look at the quality of reporting from such persons to the management company Boards, the quality of their review of the reporting of the management companies' delegates and the level of their challenge of the delegates.

For larger management companies, the Letter states that those individuals conducting managerial functions should be full time employees. Further, the Central Bank expects in all cases that resourcing levels available to management companies should be kept under review as the investment funds under their management grow in scale and complexity.

As readers will be aware, under the Central Bank's existing requirements, often referred to as the "Location Rule", half of the managerial functions must be performed by at least two persons resident in the EEA (or such other country as permitted by the Central Bank) while the remaining half can be performed by persons resident outside the EEA. However, the Letter states that a management company "*must appoint locally-based persons who conduct managerial functions*". Further clarity from the Central Bank as to whether this represents a departure from its existing requirements will be required in order to assess any implications for existing governance arrangements, many of which rely on designated persons who are located outside of Ireland to discharge management functions.

Delegate oversight

The Letter requires management companies to assess the level of due diligence carried out on delegates, both initially, for the purpose of determining appointment, and on an ongoing basis thereafter. Where management companies rely on delegate policies and procedures they will need to ensure that they have reviewed and approved the policies and procedures as being fit for the purpose for which they are being relied upon. The Central Bank expects ongoing effective engagement with delegated investment managers to be demonstrated including by high quality delegate reporting, evidence of challenge by the management company, and documented service level agreements (SLAs) for all delegates.

Director rotation, CEOs and diversity

The Letter indicates that consideration should be given to regular and adequate rotation of directors to ensure independent challenge is maintained throughout the life of the management company. The Central Bank has indicated that the independent non-executive director designation may not be appropriate for directors who remain on a Board for more than 10 years.

The Letter indicates the Central Bank's expectation that all but the smallest management companies should have a full time CEO with responsibility for the day to day running of the business.

Echoing previous press releases and commentary issued to industry by Central Bank officials, the Central Bank has again pointed to the need for greater diversity at Board level. The Central Bank has specifically called for gender diversity to form part of a management company's review of its governance arrangements.

Approval by Boards of additional funds and sub-funds

The Guidance requires the Boards of management companies to receive specific information and documentation for review and approval in advance where it is proposed to establish a new fund or sub-fund. The Central Bank expects the Board to be engaged early in the product development process and not just immediately before the product is approved by the Central Bank. Board approval procedures and practices should be reviewed and updated as necessary to address this requirement.

Role of the Organisational Effectiveness Director

The Central Bank has asked Boards to assess and if necessary address the following matters in connection with this role. In each case Boards should ensure that evidence is in place of communications involving the Director, the challenge to existing practices, the analysis undertaken, how the relevant conclusion was reached and associated Board reporting;

- (i) The adequacy of existing resources within the management company;
- (ii) Interactions between the Director and the designated persons carrying out managerial functions which should be at least quarterly or as necessary;
- (iii) The Director should be particularly cognisant of the findings in relation to Designated Persons and delegate oversight;
- (iv) The Director should report to the Board at least annually and this report should include detail on how conclusions with regard to resourcing were reached;
- (v) A documented Board effectiveness evaluation should be conducted on an annual basis. This review should include findings and time specific actions;
- (vi) Consideration of conflicts of interest and personal transactions should be undertaken on an ongoing basis;

- (vii) A detailed report should be presented to the Board of the management company at least on an annual basis which should encompass, at a minimum, information pertaining to each of the matters prescribed in the Guidance.

Risk Management Framework

The Central Bank has reiterated the requirement to prepare a Board approved, entity specific risk management framework, including a risk appetite statement and risk register.

Actions to be taken by management companies

The Central Bank expects each management company to critically assess its compliance with the Guidance and the legislative requirements underpinning it. The Central Bank asks that the Letter be discussed and considered by the management company's Board and that the management company's assessment should be completed and an action plan discussed and approved by the Board by end of the first quarter of 2021.

The Letter states that the action plan should at a minimum consider the following:

- (i) The time commitment, skills and expertise of available resources;
- (ii) The management company's retained and delegated tasks, including how ongoing independent challenge of all delegates can be ensured;
- (iii) The tasks required by the framework, including those that must be completed on a fund by fund basis;
- (iv) How resources and operational capacity will need to increase to take account of any increase in the nature, scale and complexity of the funds under management since authorisation or the last time the management company critically assessed its operations;
- (v) How resources and operational capacity will need to increase to deal with a market and/or operational crisis.

There are some preliminary questions which need to be addressed by each management company, particularly in relation to the resourcing requirements. There are some open issues which will require further clarity from the Central Bank in this regard, in particular whether or not the Central Bank intends to re-visit its "Location Rule" and the flexibility for smaller management companies and self-managed investment funds to comply with the "three FTE" requirement by increasing the time commitment of designated persons. Management companies that receive risk management programmes from the Central Bank will have additional specific actions to take to address perceived shortcomings in how they have complied with the Guidance to date.

The Central Bank has indicated that there will be future engagement with the funds industry in relation to the implementation of the Guidance during the course of 2021 to assess the actions taken by individual management companies to enhance their current operations and governance.

How can Dillon Eustace help?

Dillon Eustace is well placed to guide Boards on the requirements of the Letter and to assist Board discussion on the options available to management companies to address its requirements. We can help facilitate any necessary discussions with the Central Bank. We can design and document compliance plans, review existing arrangements and document any policies and procedures required to be put in place.

If you need any assistance, please do not hesitate to contact any member of the Asset Management and Investment Funds Department.

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